Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Ducheny	Analyst:	Darrine Distefano	Bill Number:	SB 172
Related Bills:	See Legislative History	Telephone:	845-6458	Introduced Date:	February 12, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Enterprise Zones/Redesignation of Manufacturing Enhancement Area

SUMMARY

This bill would:

- ❖ require the Technology, Trade, and Commerce Agency (TTCA) to designate an enterprise zone (EZ) within the boundaries of a specific existing manufacturing enhancement area (MEA), and
- ❖ allow all EZs to be designated for 20 years if certain criteria is met.

PURPOSE OF THE BILL

According to the author’s staff, the purpose of this bill is to eliminate the MEAs and continue the incentives offered in EZs by extending the designation period if conditions are satisfied.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2004.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law provides special tax incentives for empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

Qualified zone businesses operating in federal empowerment zones and federal enterprise communities are eligible to receive two tax incentives: (1) tax-exempt private activity bonds to finance certain facilities; and (2) the “brownsfields” tax incentive, which allows taxpayers to expense (rather than capitalize) certain environmental remediation expenditures. Qualified empowerment zone businesses are allowed an additional $20,000 depreciation expense deduction.

Under the Government Code, existing state law provides for the designation of EZs and MEAs. Using specified criteria, the TTCA designated two MEAs (Calexico and Brawley) and 39 of the authorized 42 EZs from the applications received from the governing bodies. EZs are designated for 15 years, and each MEA is binding for 15 years beginning January 1, 1998. Currently Calexico is designated as both an MEA and an EZ.

Board Position:			Department Director	Date
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An EZ designated prior to 1990, may have its designation period extended to 20 years if it meets the following requirements:

- The EZ received a superior or passing audit from TTCA.
- An updated economic development plan is submitted to TTCA, that justifies the additional five-year designation period.

This extension does not apply to EZ's designated after 1990.

Under the Revenue and Taxation Code (R&TC), existing state law provides a hiring credit for taxpayers conducting business activities within an MEA. The hiring credit is allowable to businesses located in an MEA for a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated an MEA and meet certain other criteria. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on MEA income.

Also, under the R&TC, existing state law provides special tax incentives for taxpayers conducting business activities within the EZ. These incentives include a sales or use tax credit, a hiring credit, a business expense deduction, a net interest deduction, special net operating loss treatment, and a tax credit for employees working in an EZ.

THIS BILL

This bill would require TTCA to designate an EZ within the boundaries of an MEA designated prior to January 1, 2004, including any expanded area of an MEA. Once designated, the area would no longer exist as an MEA, and all MEA benefits would no longer be available. When the last MEA is designated as an EZ, the laws governing MEAs would thereafter become inoperative. Provisions added by this bill could not be interpreted to increase the number of EZ's authorized to be designated.

This bill would extend the designation period for EZs. As a result, EZs created after 1990 would be eligible to have the designation period extended from 15 years to 20 years if they meet specified criteria.

Based on information from TTCA the following EZ's would be eligible for the extended designation: Altadena/Pasadena; Antelope Valley; Coachella Valley; Delano; Kings County; Lindsay; Long Beach; Merced/Atwater; Oakland; Oroville; Richmond; Army Depot (Sacramento); San Ysidro/Otay Mesa; San Francisco; Santa Ana; Shafter; Shasta Metro Redding/Anderson; Shasta Valley Siskiyou County; Stockton; and Watsonville.

Also, this bill made several technical changes.

IMPLEMENTATION CONSIDERATIONS

This bill would require the EZ to be designated within the boundaries of the existing MEA. It does not require the geographical area to be identical to the MEA. As a result, certain taxpayers may fall outside the boundaries of the EZ, and therefore, would not be eligible for MEA or EZ incentives.

One section of this bill requires an area within the boundaries of an existing MEA to be converted to an EZ, while another section requires an MEA to be designated as an EZ. In order to avoid confusion, the bill should be amended to maintain consistency.

A single area in Calexico is currently designated as both an MEA and an EZ. This bill extinguishes the designation of an area as an MEA once it is designated as an EZ. It also requires the number of MEAs to be reduced by the number of areas designated as an EZ. It is unclear whether enactment of this bill extinguishes the Calexico MEA since it already exists as an EZ. The author may wish to clarify whether this bill would apply to Calexico.

Once the area is converted to an EZ, it is unclear whether a taxpayer would lose the right to apply existing MEA hiring credits and credit carryovers obtained in prior tax years. The author should include language allowing the taxpayer with existing MEA hiring credits to apply that credit against the income from EZ business activities.

It is unclear if those employees previously qualifying the taxpayer for the MEA hiring credit would automatically qualify the taxpayer for the EZ hiring credit. If not, the taxpayer would have to obtain new vouchers for those employees. The author should include language allowing the employee who qualified the taxpayer under the MEA to be a qualified employee under the EZ.

It is unclear what impact this bill would have on fiscal year taxpayers that are claiming the EZ tax benefits. Taxpayers that operate on a fiscal year may be in the MEA for the first portion of their taxable year and in an EZ for the remaining portion of their taxable year. It is unclear what tax benefits would be available to the fiscal year taxpayer or how the taxpayer would claim the new benefits. The author should include language allowing fiscal year taxpayers to apply income generated from business activities in the MEA to be considered income generated in the EZ for purposes of applying tax incentives.

<u>TECHNICAL CONSIDERATIONS</u>

Section 7085 of the Government Code requires TTCA to provide a report to the Legislature on the effectiveness of the EZ program. Before the conversion of program areas (PA) to EZs, this section had the requirements for the designation of a PA. The reference to this section on page 4, line 6, is no longer applicable, and should be deleted.

LEGISLATIVE HISTORY

AB 11 (Garcia and Vargas, 2003/2004) would require TTCA to designate the City of Brawley as an EZ, subject to approval by the city council, and would apply the EZ special tax incentives provisions of the R&TC for taxpayers that conduct business activities within the EZ. This bill is currently in the Assembly Appropriations Committee.

AB 708 (Correa, 2003/2004) would allow all EZs to be designated as an EZ for 20 years. This bill is currently in the Assembly Appropriations Committee.

AB 516 (Matthews, 2003/2004) would expand the 20-year designation to include an EZ located in a rural area. This bill is currently in the Assembly Appropriations Committee.

AB 523 (Vargas, 2001/2002) would have required TTCA to designate an EZ within Imperial County (that included the cities of Brawley and Calexico) that was previously designated as an MEA, upon the request of the county's board of supervisors. This bill was amended September 1, 2002, to add urgency language to the existing Welfare and Institutions Code. The Governor vetoed this bill because it would have increased the pharmacy-dispensing reimbursement to the amount set prior to the 2002 Budget Act.

AB 1846 (Correa, 2001/2002) would allow all enterprise zones (EZ) to be designated as an EZ for 20 years. This bill failed passage in the Senate Revenue & Taxation Committee.

OTHER STATES' INFORMATION

Currently, 29 other states have economic development areas that allow similar tax related incentives to those provided in California's economic development areas. The number of economic development areas varies from state to state. For example, California currently has 49 economic development areas (that include EZs (39), Manufacturing Enhancement Areas (2), Local Agency Military Base Recovery Areas (7), and Targeted Tax Areas (1)); New York has 58, Florida 32, Illinois 93, and Michigan 23. However, no information was found stating the length of time other states designate economic development areas.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This chart reflects the revenue impact for the extension of the EZs only.

Revenue Impact Enterprise Zone Extensions ($ Millions)			
Fiscal Year	2007-08	2008-09	2009-10
Revenue Loss	-10	-20	-35

This bill does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

Extension of the Designation Period for EZs

Revenue losses for the extension of EZ status would largely depend on the amount of qualifying property purchased subject to the sales tax, the amount of wages paid to qualifying employees, and the state tax liabilities of employers claiming these tax benefits.

The revenue impact of the extended designation period for EZs would first occur in 2007, the original year of expiration for 1991 designations. Under current law, some businesses in expired EZs would have unused carryover credits and net operating losses (NOLs) that would continue.

For 2007, the current law revenue impact is $79 million. This includes $63 million in continuing losses from the 21 existing EZs and $16 million for 18 expired EZs that only use carryover credits and NOLs.

Under the proposed law, the total impact for the remaining 26 EZs (13 EZs that were designated in 1986 would conclude their 20-year designation in 2007) would be $89 million. In 2007, the first five EZs that were designated after 1990 and scheduled for expiration would be extended under this bill. Therefore, it is estimated that this bill would result in an additional loss of $10 million in the first fiscal year. As EZs continue to reach their normal expiration dates of 2008 through 2012, the number of EZs impacted by this bill would continue to increase. As a result, the revenue impact of this bill would also continue to increase over subsequent years.

Current law permits another EZ to be designated upon the expiration of an existing EZ, which was taken into account in this analysis.

Conversion of MEAs to EZs

There are two MEAs – Brawley and Calexico, both of which are in Imperial County. The Calexico MEA is also an EZ with identical geographic areas. Therefore, since Calexico is already an EZ, the revenue estimate provided below addresses the conversion of the Brawley MEA to an EZ.

A revenue estimate cannot be provided on the conversion because only one significant new business in Brawley is currently using MEA credits. Due to its large size and insufficiency of other viable businesses in the area, any estimate about the impact of conversion to an EZ would necessitate disclosure of that business' confidential tax information.

LEGISLATIVE STAFF CONTACT

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